DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15428
San Diego, Calif. 92115

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THE MARKET: Suddenly, everyone is talking about inflation and (believe it or not) deflation. The wags are coming out with their aphorisms too. Here's a new definition of inflation, "inflation is when a fellow pays you $50 for $25 worth of work, and then you spend that $50 for a kitchen chair worth $15."

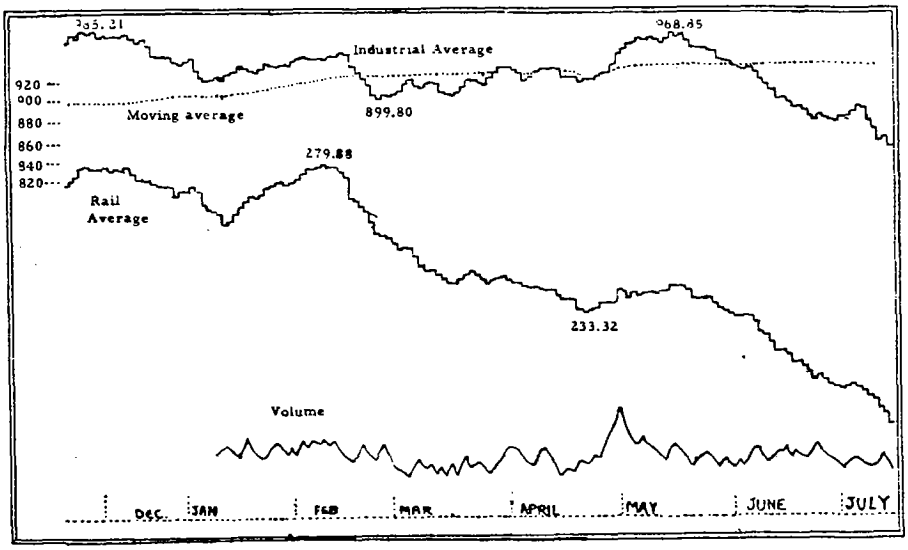
Perhaps more ironic than the inflation definition is this one on money problems: "A money crunch is when you need money and can't find it. A money crisis is when you have to have money and can't find it."

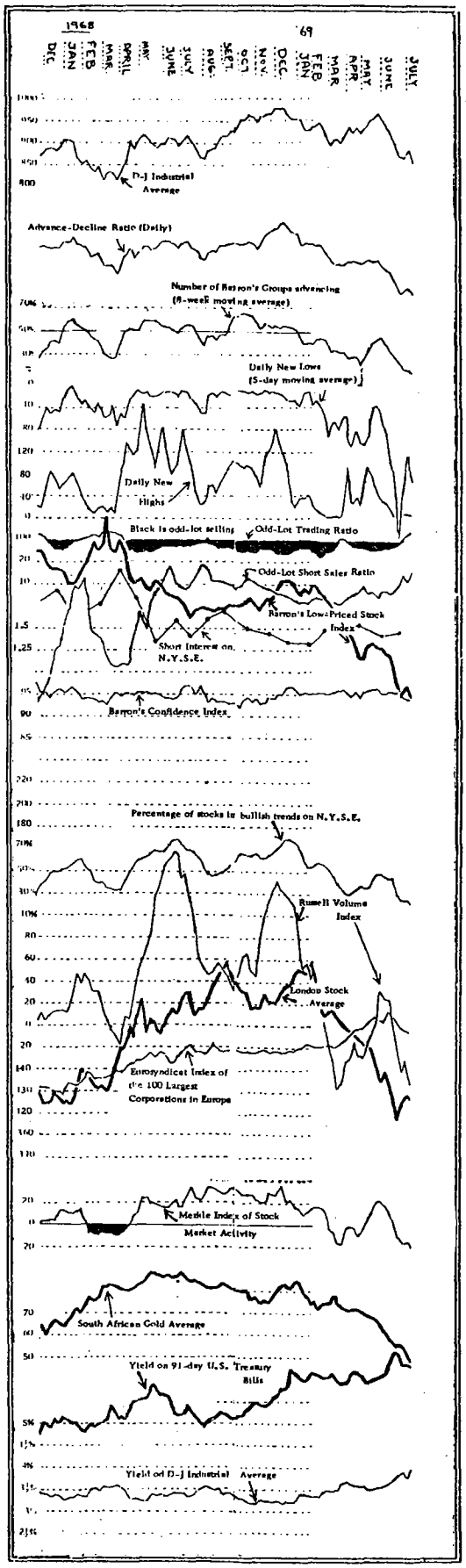
So far, it seems to me, the nation is going into a money crunch. From across the nation come reports of public and private projects being shelved for lack of funds. A Pennsylvania official stated last week, "New public-works projects are at a virtual standstill." When the city of Shreveport, La., failed to attract a single bid on an $8 million bond offering, one city official stated, "Raising money for schools, roads and sewers hasn't been this tough since reconstruction."

Last week Minnesota failed to draw any bids at all for a $30 million offering of trunk-highway bonds (the state interest limit is 5%). In New Jersey, California, Kentucky and Pennsylvania interest rate ceilings have forced curtailment of some long-term school bond financing.

The Wall Street syndicates are getting their Baptism of Fire as well. Last week, a giant offering of 1.5 million Atlantic-Richfield common shares fell with a thud as the syndicate bought the 1.5 million shares at $112 (which they hoped to sell at $115.25), only to see the stock fall to $107 a few days later.

To turn to Wall Street itself, the bear market moved on with the Industrial Average touching a 1969 low of 847.79 on July 10. On the same day the Rails hit a low for the year at 206.90. The dismal action was confirmed by fresh new lows in both the advance-decline ratio and the D-J 40-Bond Average.




1968
'69
D-J Industrial Average
Advance-Decline Ratio (Daily)
Number of Barron's Groups advancing (8-week moving average)
Daily New Lows (5-day moving average)
Daily New Highs
Black is odd-lot selling
Odd-Lot Trading Ratio
Odd-Lot Short Sales Ratio
Barron's Low-Priced Stock Index
Short Interest on N.Y.S.E.
Barron's Confidence Index
Percentage of stocks in bullish trends on N.Y.S.E.
Russell Volume Index
London Stock Average
Eurosyndicat Index of the 100 Largest Corporations in Europe
Merkle Index of Stock Market Activity
South African Gold Average
Yield on 91-day U.S. Treasury Bills
Yield on D-J Industrial Average

 On Friday, July 11, Industrials rallied but as has been characteristic since the 1969, May peak, Rails diverged, dropping to new lows again. Earlier in June the Rails penetrated their 1968 low of 214.58. As this is written, the Rail Average is sinking below its 1967 low of 215.16.

How significant is the Rail action? As Robert Rhea once pointed out, during a primary movement a penetration by one Average is followed (in the majority of cases) by a confirmatory penetration in the other Average. Since Rails have now violated both their 1968 and 1967 lows, the odds would favor an Industrial penetration in the primary or bearish direction. An Industrial confirmation would therefore entail first a breaking of the 1968 low of 825.13, then a violation of the 1967 low of 786.41.

The public's reaction to the decline (so far) is not particularly comforting. Odd-lotters (whose activity is generally considered to be indicative of public sentiment) switched from selling to buying on June 13. Since June 13, despite persistent weakness in the market, the odd-lot public has stayed on the buying side of the market on all but three trading days. Odd-lot short sales, which usually run high as a bottom approaches, have remained decidedly low. Personally, I would guess that odd-lot shorts could rise to the 50 to 100 thousand share per day level as and when this decline terminates.

Confirming the general complacency exhibited by the public, total trading volume too has stayed relatively low on the decline. Evidently, despite major losses sustained in many stocks, the slide has failed to bring out any indications of urgent selling.

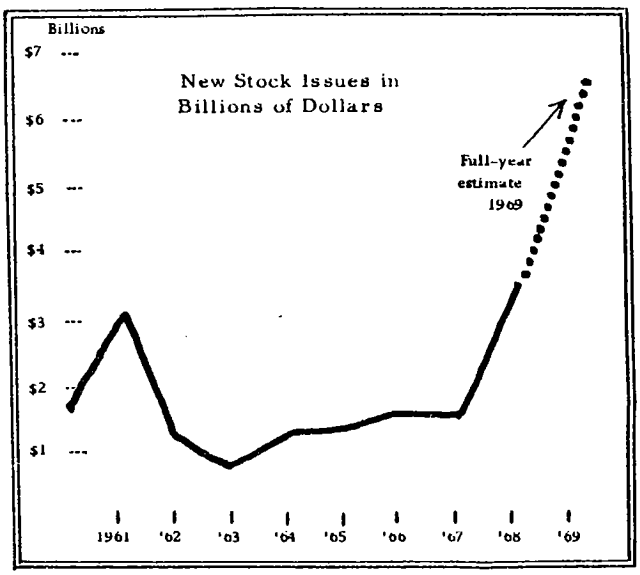
Personally, I do not take the relatively low volume on the decline as a particularly bullish sign. Rather, it means that the market has been dropping while few investors actually sold stocks and moved out. This means that many stocks have actually lost 1/3 to more than half their value with the great majority of their holders "locked in" with the full losses. This type of situation often leads to frantic selling in the final third of a decline. At such times, those who have held on to their declining shares finally give way to panic, selling at any price the market will bring.

So there we have it, a decline from Dow 968.85 (May 14) to 843.14 (July 14) with accompanying complacency on the part of the public. If the downward movement for 1969 has terminated, there isn't much in the market action so far to prove it.

I'll amend that last statement with a single ray of hope. Daily new lows hit 594 on June 23 with the Dow at about 870. On July 14 with the Dow closing at 843.14 the daily new lows hit 303. This does suggest a decrease in total downside momentum. In retrospect those figures could be at least temporarily significant, but as of now it is far too early to tell.

WATER IN 1969: New issue markets are relatively rare. One occurred in 1928-29, one occurred in 1945-46, one took place in 1960. But the greatest new issue market in history began in 1967 and it is still in effect. The accompanying chart shows new stock issues in billions of dollars, from 1960 to date (the full year 1969 is estimated and shown by a dotted line).

Actually, few people realize that most of the 1928-29 speculation was in the great blue-chips, in such stocks as RCA, Anaconda, GE, GM, and the bank stocks. Nothing could be further from the truth today. Today hamburger stands, nursing homes, untested science stocks, restaurant chains, health services, leisure gimmicks, dot the new issue lists. Many have been sold to the public at huge premiums over their actual book value. For instance, a promotion may entail giving the public 20% of the book value of a company for cash equal to 80% of the equity money. Thus these issues in many cases have a tremendous amount of "water" in them. If they were to drop to anything like book value (and I remember that in the 1940's many stocks were gauged by their book value), these stocks could lose a major portion of their market price.



To provide an idea of what has been going on, I am listing a few 1969 new issues together with the market value of each company based on the price of the stock at time of issue. I leave it to readers to figure what these companies might be worth in a few years (and I concede that some may be good outfits, but you can't prove it yet): Applied Logic Corp. worth $54 million at the market, Broadway Joe's worth $7 million at the market, General Health Services valued at $29 million, Stage Delicatessen worth $5 million, Viatron

Computer Systems valued at $46 million at the market.

Incidentally, referring to the chart on page 2, speculators paid out $3.9 billion for new issues during all of 1968. That rate is being doubled so far in 1969, and if the stock market doesn't end it, the total for 1969 new issues could run near $7 billion.

HOPES: One of the phenomenons of the 1960's has been the amazing growth of the funds. The little investor (and many medium and big investors) have become increasingly enamoured of the funds, and the power of those brooding professional geniuses on Wall Street who know how to do nothing but make money. Magazines have extolled the wonders of the mysterious fund managers, the bright, intense young men who frequent Wall Street's canyons. And more lately, the super-geniuses, the "gunslingers" of the Street have come in for special publicity.

All through the early 1960's the influence of the funds increased. That was during the primary bull market, when fund buying naturally had a great effect on the market, particularly heavy, concentrated buying. In February, 1966, the primary bear market began. During the upward part of the second phase of the bear market, an era lasting from October, 1966 to May, 1969, the funds' influence remained strong. In fact, so large is the fund influence that it is estimated that more than half of all N.Y.S.E. trading is now the result of fund purchasing or selling.

The proliferation of funds has developed into avalanche proportions of late. Last year 80 (yes eighty) funds were started. In the first quarter of 1969, 26 new funds appeared. Says S.E.C.'s Soloman Freedman, "We don't have a count on the funds waiting to register because we're too busy to poll all our five branches to find out how many more there are." Fund competition is now fierce, and the latest phenomenon is seen in the public's trading in funds, buying and selling and switching into various funds just as if they were common stocks. To this writer the entire fund situation has moved into the theatre of the absurd. But historically, it may be remembered, Wall Street tolerates the absurd for only so long.

One of the latest market "indicators" to gather a broad following is the liquid holdings of mutual funds. When fund liquidity is rising it is thought that the technical condition of the market is strengthening since funds then have that much more cash to spend. When fund liquidity is decreasing, the market's strength is weakening since theoretically the funds are using up their cash "ammunition."

But recently, everything has not worked to perfection in regards to the fund liquidity ratio. For instance, during the last quarter of 1968 fund liquidity dropped from over 7% to 6%. Despite this, the market declined into the first quarter of 1969. Now it turns out that the funds bought heavily last May, lowering their liquidity ratio, but despite the big fund buying the market continued down. Evidently "somebody" is selling more stock than the funds can absorb.

One wonders what will happen if or when the public becomes disillusioned with the funds and fund redemptions begin to outweigh fund purchases. I believe that day is coming—very probably during 1969. The figures show that a high in net fund purchases over sales occurred in January, 1969, with net purchases over sales reaching $479 million. By last April net purchases over sales declined to $306 million. In May the surplus had shrunk to just $164 million. If this trend continues, we might see fund redemptions climb over sales before 1969 is out.

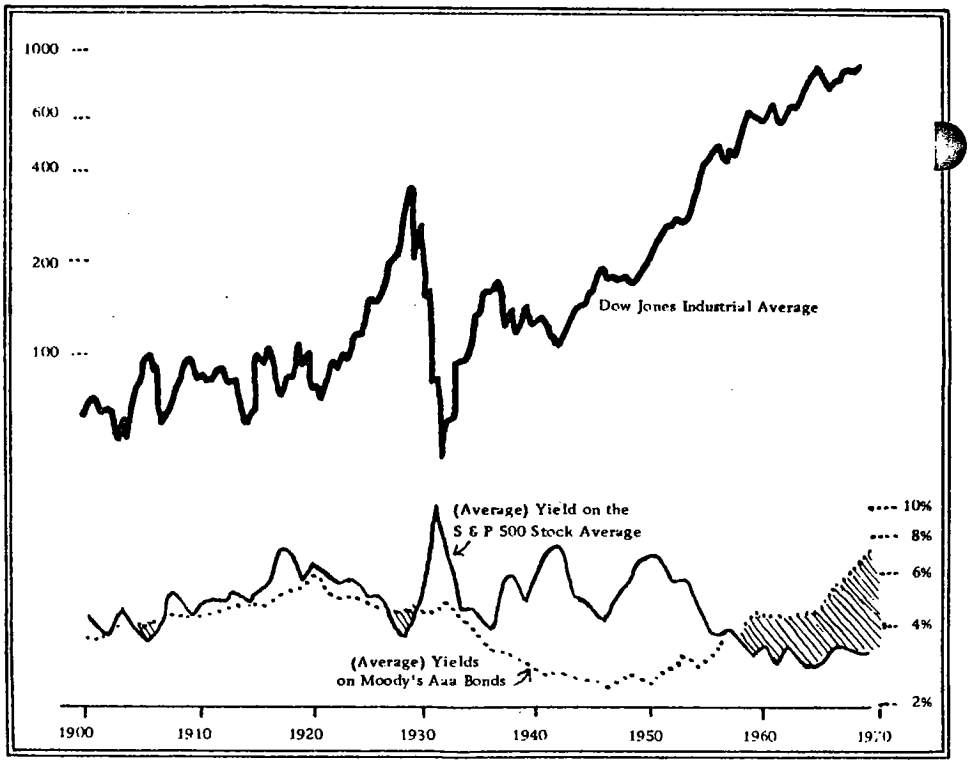
I find it significant that odd-lotters bought on an increasing scale starting in mid-May, and as of this writing the odd-lot public is still on the buy side of the market. This would suggest that despite decreasing supluses of inflowing cash to the funds, the public is still bullish. I expect the public to turn increasingly pessimistic as this bear wears on. When the public finally becomes sour on the outlook for the economy, and market and the funds, I expect the net redemptions of the funds to bring tremendous pressure on Wall Street.

As a matter of fact, with the rate of net new cash inflow dropping, I believe that the funds are becoming quite concerned. I believe that the rise in liquid holdings of the funds during 1969 is mainly an attempt by the funds to push up cash holdings against the time when redemptions surpass sales.

For this reason, I feel that the amount of sales over redemptions for mutual funds over the period ahead is going to be well worth following. If and when net redemptions take over, I would regard this as a danger signal. It will mean the beginning of pressure from the funds on Wall Street, not voluntary pressure but forced pressure.

Before the bear market is over it would not surprise me to see an avalanche of fund money force this market down to depths far lower than even the bears now foresee. This is one of the great unknown dangers of the current bear market. Namely, what happens if hundreds of millions of dollars of fund money has to be thrown into the stock market to pay off disillusioned fund holders who want cash above all?

STRAIN: The accompanying chart is from data received from the very fine Holt Investment Advisory Service. It is drawn to show the long-term action of the Dow Industrials from 1900 to date, together with average yields on the broad S & P 500 Stock Average and average yields on the widely-followed Moody's Aaa or top-rated Bond Average.



Turning to the (dotted) bond yield line, note that since 1900 we have had two major bear markets (i.e., declining yields) and one major bull market (i.e., rising yields) in the bond market. The first bear market in bonds began around 1900 and ran to about 1920. A credit collapse in 1920-21 served to liquidate much debt, thereby laying the groundwork for a bull market in bonds which lasted to 1946.

It is important to note that all through the 1930's and most of the early 1940's or during the Depression years the bull market in bonds held sway. This was actually a great (but unrecognized) plus from the period of 1920 to 1946. A rising trend in bond prices means that the atmosphere for new financing remains relatively favorable.

The shaded portions of the chart denote those rare periods when yields on stocks were greater than those on bonds. Here again, the chart is most instructive in comparing the 1929 period with the present. For note that during the period of the late-1920's bond yields were actually trending down. The shaded or inverse-yield area of the late 1920's was actually brought on by stock yields diving below 3%, even while bond yields were declining. Thus only the stock yield trend was unfavorable.

In 1946 the era of the mountainous peacetime deficit began. Bonds yields began to rise (as bond prices sank). The shaded area during the 1960's was not brought on by a plunge in stock yields alone, it was brought on by the twin unfavorable factors of rising bond yields and declining stock yields.

The whole shaded portion since 1958 may be viewed as an "out-of-kilter" period in American finance, a period which included deficit after deficit in the U.S. balance-of-payments, degradation of U.S. coinage, severe weakening of the dollar together with the greatest and longest era of stock speculation in U.S. history.

In the lead-off article in the July 5 issue of Business Week, a corporate Treasurer is quoted as saying, "We'll never see the good old days of 5% money again." I believe this man is dead wrong, and that his thinking is based on justifying his action. His action probably included borrowing in the current market when he should have been lending (lending at the highest interest rates in 100 years). Another corporate leader in the same article says, "The persuasive thing is that building costs are rising at the rate of 1% a month, so it is costing us 12% a year in increased building costs if we delay. By building now, we may avoid some future inflation." I am sure this man would also tell his boss that we will never see low interest rates again.

At the turn of the century Charles Dow wrote: "There is always a disposition in people's minds to think that existing conditions will be permanent.....The one fact pertaining to all conditions is that they will change." Glancing at the chart again, note that the period of 1928-29 is a shaded portion, that following that there is a clear portion during which time stock yields were higher than bond yields. Then there is a shaded portion beginning with 1958 and lasting to the present. If todays shaded portion (showing bond yield above stock yields) lasts even another five or ten years, the gentlemen quoted above will have been reasonably correct. But my bet is that the shaded portion which began in 1958 will be followed by an unshaded area on the chart. Let history be the judge.

ECONOMIC SCRAPBOOK: With the whole market-social-economic outlook turning increasingly critical, I have decided to add this section to the Letter. The section will run on a continuing basis.

July 1, 1969....Surtax extension squeaks through the House and goes to the Senate. Fed contemplates controls on commercial bank paper. Commercial paper rates creep higher with the shortest maturities of finance-companies at 8.37%. Truth-in-lending laws become effective.

July 2, 1969....Factory orders fall .9%, due to drop in durable goods. Talk about new pressure to increase the current record 8.5% bank prime rate. Construction spending falls .3% in May.

July 3, 1969....Lead prices rise from 15¢ to 15.5¢ per pound. Britain's reserves of gold and convertible currencies rise $29 million. Retail chains' sales rise to a record in June, but rise is lowest for the year on a year-to-year basis.

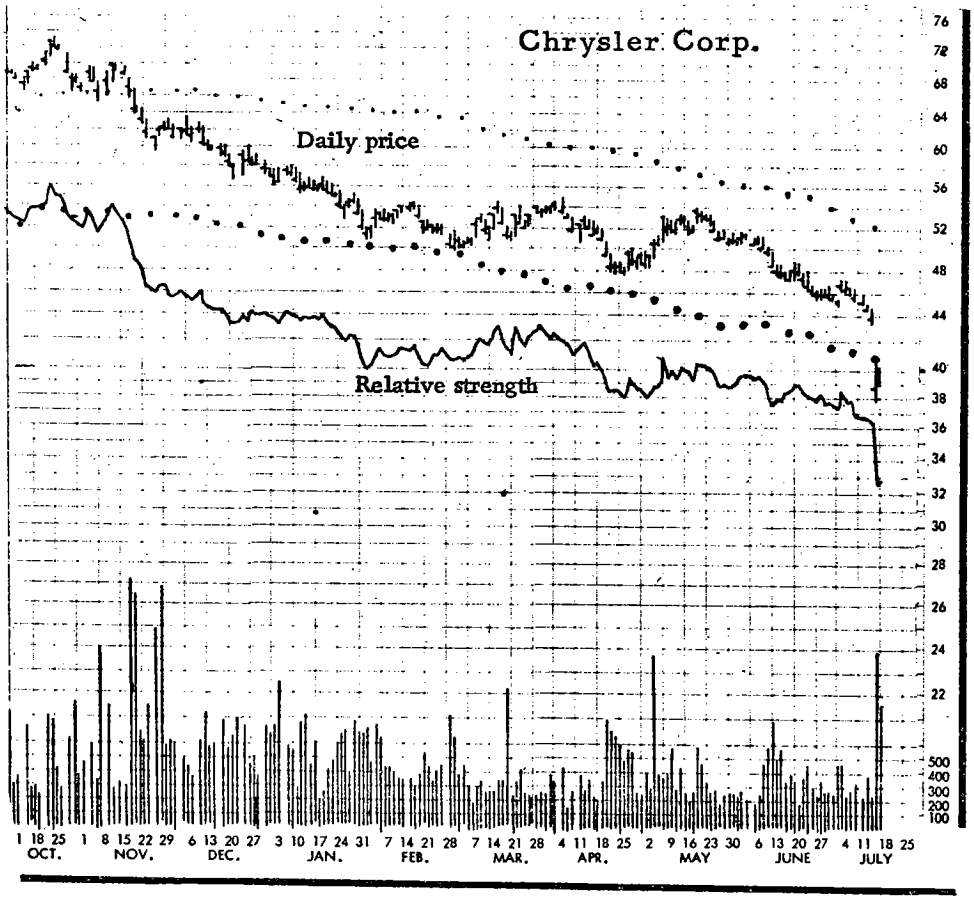
July 7, 1969....Purchasing executives claim that rate of orders slowed sharply in June, possibly indicating a business downturn. Treasury Secretary Kennedy met with leading bankers to ask them to resist another boost in the prime rate. Installment credit in May posted an $846 million jump, largest advance since last October. Net borrowed reserves of commercial banks continued strapped at minus $1.21 billion, but N.Y.C. bank loans to business rose, nevertheless, by $191 million. Savings bond redemptions exceed sales for 7th consecutive month. The Administration expected to ask for a raise in the 4.25% savings bond ceiling.

July 8, 1969....The yields on the 91-day and 181-day Treasury bills rise to record highs, the 91-day bills going to 7% for the first time in history, the 181-day bills going to 7.3%. Secretary of the Treasury Kennedy meets with nation's leading bankers, telling them that interest rates alone won't do the job of curbing credit. He neither asked nor received promises that the prime rate would not be raised. 290 over-the-counter stocks are subject to 80% margins. Leading aircraft companies, it is learned, are laying off employees due to cut-backs in defense contracts.

July 9, 1969....Senate ties reforms to 10% surtax bill, probably holding up vote on that bill to September. Gold in London hits monthly high of $42.10. Congress recommends a $191.9 billion Federal spending ceiling. D-J Industrial Rail, 40-Bond Average and A-D ratio sink to new 1969 lows.

July 10, 1969....The Fed speaks against raising the 6.25% ceiling on Certificates of Deposit at the banks, thus indirectly sanctioning further disintermediation. Chrysler, due to a profits squeeze, is cancelling projects and retrenching sharply, terminating some expansion plans in mid-stream.

Last week I discussed the shocking collapse in Anaconda, one of the 30 Dow stocks. This week Chrysler joined Anaconda as it smashed down into the low 30's. The news, Chrysler is cutting back on most of its current $300 million expansion plants. On two Chrysler construction projects, work has been totally stopped, letting the cement foundations and steel basic structure lay where they are. Reason, a profit squeeze caused by sliding sales. (Chart courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002).



GROUPS: It is estimated that last year one million children died of starvation in Biafra (see photo). It is thought that a few hundred thousand more will die in the next few months. The U.S. military budget is now around $80 billion. Over-eating is a national problem in the U.S. The bastion of U.S. economic strength, the dollar, is wobbling and is subject to increasing doubt (see part of interview with Senator Symington from U.S. News and World Report).

Sometimes I get sick of just telling subscribers what I think is going on— and how to prepare for it. The real problem with the world is that it is sick and scared. Its leaders are fearful, compromising men, its populations are so weak that they allow men who are less-than-geniuses or saints to rule.

Here in San Diego and all over the West Coast encounter or sensitivity groups are being formed. Men and women in these groups attempt to face their real selves, their real feelings and thoughts. People change, many find that they are able to feel and then live by their feelings. From my observations, I would guess that 90% of the world's population lives by what they have learned in the past or what someone is telling them now. That simply does not work. It's working worse now than ever before, because the world's problems are getting bigger.

The road to the answer to the world's problems, in my opinion, is in getting people sane and in getting them to feel. I firmly believe that the new sanity developed by group communication is the hope of the world. It's the hope because it can bring human beings somewhere near their true potential. If there's a group in your area, try it. Time is running out.

Coincidentally, after I wrote the above piece a front page article appeared in the Wall Street Journal entitled "The Truth Hurts" and stating that some companies see more harm than good in sensitivity groups. My reply is that the truth always hurts, but ignorance of the truth hurts a good deal more. As for more harm, of course, but to the companies, not to the individuals. If a man finds that he is wasting his life working on a job he doesn't like or want and if the man quits, of course it harms the company. But if that man goes off and does what he really wants to do, and if that company replaces him with another man who really enjoys working for the company only good can come from it. The truth about ourselves is always there, it exists. We can face it and perhaps fullfil ourselves or ignore it and waste our lives and the lives of those we deal with.

VIETNAM: If this bear market leads to collapse and upheaval, I firmly believe that the outcome will be a titanic struggle between the forces of truth (based on what men really think and feel) and the forces of ignorance (based on man's greed, guilt, violence, and hatred). A case in point is Vietnam. If we pull out, South Vietnam will probably ultimately be taken over by the North. Then we will have fought for nothing. The war from the military standpoint will have been lost. Nixon states that we are going to pull out. But nobody mentions that the war will probably then be lost. Nixon is moving towards ending the war, but he won't tell the American people that this policy will result in a takeover by the North. Give them what they want (and end to the war), but don't tell them what is happening. Why, because it doesn't sound good. Why the devil does everything have to sound good? The truth often sounds terrible, but truth is truth, and that's what the world needs now.

"IF WE BLOW THE DOLLAR"—

Q How would you adjust the priorities between military spending and other needs?

A Let me try to answer by giving an example. This year the Administration was requesting 5.2 billion dollars for ammunition for Vietnam alone, and only 2.3 billion, or less than half, for all education, primary and secondary, in this country.

Here is another way to put it: For every boy and girl in the United States, this budget requests $44 for education; whereas the ammunition requested for every enemy soldier in South Vietnam—North Vietnamese, Viet Cong and guerrilla —is $20,400 per enemy.

As I see it, the United States has a platform of security and well-being, held up by three legs. Any platform can stand with three legs, none with two. One of these legs is political, one leg is military, and one is economic. And 95 per cent of the thinking in this town has to do with the political and the military. But the economic leg is just as important.

Therefore, our most important need is the establishment of priorities. Another word for priorities could be values. It is with that premise that for the first time I oppose this proposed weapons system; because the ever more important question is: Where should we put our increasingly limited resources?

We have in this country today over a trillion dollars in life insurance. Millions of people are living in retirement on fixed incomes. Then there is Social Security. Unions advertise the importance of various pension plans, which of course means retirement on a fixed income.

If we blow the integrity of the dollar through all this gigantic Government spending, primarily defense, we blow the whole American system, including a decent life for retired people.

Let me repeat: People I respect—private bankers as well as Government banking officials—believe the dollar is in deep trouble because of these expenditures.

The last spoonful soon